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No. 87-497

In The

Supreme Court of the United States

October Term, 1987

JEROME I. FELDMAN, *et al.*,

Petitioners,

vs.

PIONEER PETROLEUM, INC., *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF OF FIDELITY BANK, N.A., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In a case arising under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 781(b), are plaintiffs who fail to introduce any evidence suggesting they have suffered loss as a result of their investment entitled to recover damages?

2. In a case arising under section 10(b), are plaintiffs who failed to timely elect a rescission remedy entitled to pursue such a remedy against a party with whom plaintiffs did not deal and from whom they did not purchase?

3. In a case arising under section 10(b), are plaintiffs who failed to prove that any act or omission of a defendant caused them injury entitled to pursue any remedy against that defendant?

LIST OF PARTIES

The list of parties stated by petitioners should be amended as follows: Fidelity Bank, N.A., no longer exists. It was acquired by Bank of Oklahoma, Tulsa, Oklahoma, by merger in 1983 and is now Bank of Oklahoma, Oklahoma City, Oklahoma.

We submit that the argumentative reference to a sham document contained in the petitioners' list of parties is improper.

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INTRODUCTION

Fidelity Bank, N.A. (now Bank of Oklahoma, Oklahoma City) submits this brief in opposition to petitioners' petition for a writ of certiorari to the Court of Appeals for the Tenth Circuit.

The "Statement of Jurisdiction" contained in the petition is correct. The list of "Statutes and Regulations Involved" should be amended to include 26 U.S.C. § 465(b)(2).

STATEMENT

The Bradford Drilling Program.

This litigation arose out of petitioners' investment, in 1972, in an oil and gas drilling fund marketed as a tax shelter to a small group of sophisticated investors. The drilling fund was sponsored by the late William D. Bradford. Through his company, Pioneer Petroleum Co., Inc., Bradford proposed to drill a few shallow-well secondary recovery operations in the northeastern part of Oklahoma.

Bradford raised capital for his drilling program by offering limited partnership interests to a small group of investors who had previously invested with him.

In connection with the 1972 program, Bradford prepared offering documents which he made available to a handful of oil and gas investment experts located in the financial district of New York City.

The drilling program was designed to be a tax shelter. To this end it offered matched "sets" of limited partnerships. The concept was as follows: Several sets of limited partnerships would be formed. Each investor would invest cash only in a "first-tier" partnership. This partnership would drill for oil. The drilling activity could be expected to yield federal income tax deductions equal to approximately ninety percent (90%) of each investor's cash investment. If the first-tier partnership found oil, it would pledge the production as collateral for a loan. Such a loan is a "carved out production payment" or "COPP."

If obtained, the COPP would capitalize a second set of limited partnerships. The investors would then purport to "invest" in the second-tier partnerships by way of nothing

more than nonrecourse notes "payable" only out of production, if any, from the second-tier. The drilling by the second-tier partnership would generate another deduction equal to approximately ninety percent (90%) of each dollar "invested" through the nonrecourse note. Thus, for a single cash payment, an investor might be able to claim a tax deduction equal to approximately 180% of his actual investment.

The Reform of the Internal Revenue Code.

Beginning with the Tax Reform Act of 1969, Congress and the Internal Revenue Service ("IRS") have sought to eliminate the claiming of bogus tax deductions through the fiction of an "investment" by way of a nonrecourse promissory note upon which the "investor" could never have liability. *See especially, Brountas v. Commissioner,* 692 F.2d 152, 158-62 (1st Cir. 1982). In 1976, Congress flatly outlawed this abuse by amending the Internal Revenue Code to provide: "A taxpayer shall not be considered at risk with respect to amounts protected against loss through nonrecourse financing . . . or similar arrangements. 26 U.S.C. § 465(b)(4). While section 465 did not become effective until 1976, the IRS was successfully challenging programs such as Bradford's as a "mere tax gimmick" long before. *Brountas, supra.*

This predictable fate befell the Bradford program. The IRS took the position that the second-tier partnerships were a sham having as their only purpose the avoidance of federal income tax by petitioners. The IRS, however, did not dispute petitioners' right to claim legitimate deductions as to money they actually put at risk.

The Litigation Below.

Although petitioners invested in 1972, and, as the district court found, 606 F.Supp. at 922, had been aware since 1974 of the likelihood that the IRS would challenge the deductions which they claimed, they did not file suit until 1976.

Petitioners claimed that they had invested in the Bradford program because of its tax-sheltering features. The damages which petitioners sought were such amount, if any, as might be necessary to "compensate" them for any taxes they might have to pay as the result of the IRS contention that the "second-tier" of their investments was a sham.

Petitioners asserted that the offering documents did not sufficiently apprise them of the likelihood that the IRS would adopt such a position with regard to their "investment" in the second-tier. Although petitioners also included standard form counts for an accounting and rescission, neither was seriously pursued since Bradford had died in 1974 and both his estate and Pioneer Petroleum were insolvent.

Fidelity, the only active defendant remaining in this long drawn-out litigation, had nothing to do with the preparation or dissemination of the Bradford program. Fidelity was, in 1972, a comparatively small Oklahoma City bank. Its relationship to Bradford was that of a lender.

Petitioners asserted that Fidelity had improperly given the impression it had or would make COPP loans to the Bradford partnerships while either making no such loans or not making them on a *bona fide* basis.

The making of COPP loans was, in 1972, a comparatively routine practice for a small southwestern bank with an oil and gas lending portfolio. However, as shown below, the presence or absence of such a loan would have had no effect upon the position of the IRS with regard to the nondeductibility of an "investment" in which the investors were never at risk.

The Tax Court Litigation.

During all the years petitioners have contended in the

courts below that the IRS was correct in declaring that their investments in the Bradford partnership were a sham, petitioners were also litigating in the United States Tax Court on the basis, to which they had sworn under oath, that their investments were valid and that they were entitled to the full "two-for-one" deductions which they originally claimed. Tr., pps. 688-89.[1] Indeed, over the one and one-half decade-long life of the Bradford program, petitioners have deducted interest expense for interest which they claimed under oath they paid on the "second-tier" of their investment — a deduction to which none of the petitioners would have been entitled in the absence of a valid transaction (Tr., pps. 1274-77).

The Decisions Below.

The district court, 606 F.Supp. 916, held that petitioners had failed to establish a *prima facie* case and sustained Rule 41(b), F.R.Civ.P. motions.

The court of appeals affirmed, 813 F.2d 296, pointing out that a failure to prove actual damages is a "fatal flaw"; the court of appeals "agree[d] with the district court's finding that the record discloses that [petitioners] had ample opportunity, but simply failed to adduce proof on the amount of actual damages, if any, they allegedly sustained . . ." 813 F.2d at 302.

ARGUMENT

(1) The judgment of the court of appeals is correct, does not conflict with any decision of any other court, decides no unusual point of law, and presents no issue extending beyond the unique facts of this case. Review by this Court on certiorari is, therefore, wholly unwarranted.

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[1] "Tr." refers to the trial transcript

This is particularly true since the type of abusive tax shelter which petitioners sought to obtain here has been forbidden by Congress for more than a decade. Moreover, review of the issues which petitioners purport to present is, as both the district court (606 F.Supp. at 924 and nn. 5, 6) and the court of appeals (813 F.2d at 302 and n.11) correctly held, precluded by petitioners' own failure to introduce at trial any evidence in support of the opaque damage theory which they now posit.

(2) While petitioners suggest that this case presents various questions regarding the efficacy of "rescission" as a remedy in an action arising under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), no such issues are presented by this record. Rescission is an option which a dissatisfied purchaser may be able to invoke against his seller — only. *Mills v. Electric Auto Lite Co.*, 396 U.S. 375, 388 (1970). Petitioners themselves recognize the "privity" requirement of *Mills*. (pet., pp. 15-16). Since it is undisputed that the only respondent here — Fidelity — had nothing to do with Bradford's offering documents and was not a party to the sale of Bradford's programs, no question regarding the appropriate scope of the rescission option is presented by this case.

(3) Indeed, petitioners simply have no case against Fidelity, for Fidelity did not proximately cause any injury to any petitioner.

Petitioners complain that Fidelity did not make COPP loans to the Bradford program. But Fidelity never promised any petitioner it would make such loans.

Moreover, as petitioners' own evidence at trial revealed, petitioners would be in the same position with the IRS if Fidelity *had* made COPP loans to the Bradford program in

exactly the manner in which the hoped for loans were described in the Bradford offering documents. This is so because the IRS did not recommend disallowance of deductions claimed by petitioners because of anything Fidelity did or did not do. Rather, IRS recommended disallowance because of what petitioners themselves did: attempt to claim tax deductions for "investments" made only by way of nonrecourse notes upon which petitioners had no capital at risk. This position has been upheld in previous litigation involving drilling programs identical to Bradford's, *see, e.g., Brountas, supra,* and petitioners do not suggest it is incorrect. Petitioners' discomfiture thus arises from their attempt to claim tax deductions on the basis of "investments" in which petitioners "invested" nothing and risked nothing. The consistent refusal of the IRS to deem such deductions valid does not in any way depend upon the status of COPP loans. Previous decisions have disallowed such deductions notwithstanding the unquestioned existence of such loans.

Brountas, supra.

This Court need not grant certiorari to reaffirm so fundamental a principle as the rule that a section 10(b) plaintiff must prove some act of the defendant was a cause of his injury.

(4) There are oblique suggestions in petitioners' submission that this case presents issues which the Court left undecided in *Randall v. Loftsgaarden,* 478 U.S. , 106 S.Ct. 1343 (1986). It does not. *Randall* held that in an action against the seller of securities brought under section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), the measure of damages is unaffected by income tax advantages which may have accrued to a defrauded purchaser as a result of the tainted transaction.

The *Randall* Court pretermitted the question whether

this result would extend to an action under section 10(b).

The court of appeals below (813 F.2d at 301) quoted *Randall* with approval on the measure of damages to be employed in a section 10(b) case. The "fatal defect" in petitioners' damage case was, in the words of the court of appeals, that petitioners "had ample opportunity but simply failed to adduce proof on the amount of actual damages, if any, they allegedly sustained . . . "[2] 813 F.2d at 302 and n.11.

Petitioners note that the Securities and Exchange Commission ("SEC") filed a brief as *amicus curiae* in the court of appeals on the question of damages.

The SEC brief was filed before this Court decided *Randall* and was limited to an expression of the view that the decision of the court of appeals in *Randall* was erroneous.

The SEC noted the ruling of the district court in this case that petitioners had proven no damages and was careful to state that the SEC "expresse[d] no view [on the] sufficiency of the evidence of damages . . . " (SEC br. p. 27). The SEC has filed nothing in this Court.

Finally, we note that this case is the opposite of *Randall.* In *Randall,* the defendants wished to introduce evidence of income tax deductions received by the plaintiffs to lessen damages. In this case, petitioners asserted (but failed to prove) that disallowed tax deductions which they claimed but did not receive *were* damages. *Randall* did not disturb —indeed, it recognized the existence of — the view that such a speculative matter as a hoped-for tax deduction is not a compensable item of damages. *Randall,* 478 U.S. , , 106 S.Ct. at 1354.

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[2] The court of appeals erred in petitioners' favor by reading this Court's *Randall* holding to be applicable to actions under section 10(b). 813 F.2d at 302.

See also, e.g., Lasker v. Bear Stearns & Co., 715 F.2d 15, 18 (2d Cir. 1985).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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of

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CERTIFICATE OF SERVICE

The undersigned does hereby certify that a true and correct copy of the above and foregoing Brief of Fidelity Bank, N.A., In Opposition to Petition for Writ of Certiorari was mailed, postage prepaid, this _____ day of October, 1987 to:

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